

COMMONWEALTH EDISON COMPANY

BEFORE THE

ILLINOIS COMMERCE COMMISSION

DOCKET NO. 01-0423

**PETITION FOR APPROVAL OF DELIVERY SERVICES TARIFFS
AND TARIFF REVISIONS
AND OF RESIDENTIAL DELIVERY SERVICES
IMPLEMENTATION PLAN**

PHASE II

REBUTTAL TESTIMONY

SUBMITTED BY

DAVID J. EFFRON

ON BEHALF OF

**PEOPLE OF THE STATE OF ILLINOIS
CITY OF CHICAGO
COOK COUNTY STATE'S ATTORNEY'S OFFICE
CITIZENS UTILITY BOARD**

FEBRUARY 28, 2003

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REBUTTAL TESTIMONY OF DAVID J. EFFRON
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1 **I. STATEMENT OF QUALIFICATIONS**

2 Q. Please state your name.

3 A. My name is David J. Effron.

4

5 Q. Have you previously submitted testimony in this docket?

6 A. Yes. I submitted direct testimony marked as Exhibit GC 2.0, supplemental direct
7 testimony marked as Exhibit GC 2.0 (Supplemental), rebuttal testimony marked as
8 Exhibit GC 5.0, supplemental rebuttal testimony marked as Exhibit GC 5.0
9 (Supplemental), and Phase II direct testimony marked as Exhibit GC 7.0. My
10 qualifications, background, and experience are included with my direct testimony,
11 Exhibit GC 2.0.

12 **II. INTRODUCTION AND PURPOSE OF TESTIMONY**

13 Q. On whose behalf are you testifying?

14 A. I am testifying on behalf of the People of the State of Illinois, the City of Chicago, the
15 Cook County State's Attorney's Office, and the Citizens Utility Board.

16

17 Q. What is the purpose of this rebuttal testimony?

18 A. In this rebuttal testimony, I am responding to certain of the Phase II direct testimony
19 of Commonwealth Edison Company ("ComEd" or "the Company"). In particular, I
20 respond to the testimony of ComEd witnesses R. Williams, J. Williams, Houtsma,
21 Frangipane, and Hill. In this rebuttal, I am responding only to certain points raised by
22 ComEd in its testimony filed on February 3, 2003. However, the fact that I am not

1 responding to all of the ComEd testimony filed On February 3, 2003 should not be
2 interpreted to mean that I am in agreement with the positions expressed by ComEd in
3 that testimony to which I am not responding.
4

5 **III. RESPONSE TO COMED TESTIMONY**

6 **A. Distribution Operation and Maintenance Expense**

7 Q. On pages 4-5 of his direct testimony, ComEd witness Ron Williams criticizes the
8 Liberty audit because it did not specifically identify distribution operation and
9 maintenance expenses (“O&M”) incurred in 2000 that were “not in accordance with
10 good utility practice.” Assuming Mr. Williams’ statement is correct, does it
11 necessarily follow that the adjustment to 2000 test year distribution O&M proposed
12 by Liberty is invalid?

13 A. No. If the expenses incurred in 2000 were prudent and “in accordance with good
14 utility practice,” the expenses would still not be proper for inclusion in the delivery
15 services revenue requirement if those expenses were abnormal or not likely to be
16 incurred on a continuing basis prospectively. That is, because the test year is used as
17 a tool to set rates prospectively, the delivery services revenue requirement should
18 reflect a normal level of distribution O&M, not a level that includes one-time
19 expenses, even if those one-time expenses were prudent and reasonable in the
20 circumstances of the historical test year.
21

22 Q. Was the normality of distribution O&M in 2000 an issue in Phase I of this case?

1 A. Yes. Referring specifically to the proposals to normalize distribution O&M, the
2 Commission in its Interim Order noted that it was “mindful of the pendency of the
3 audit ordered by the Commission in Docket No. 01-0664” and went on to state that
4 “(t)he audit will consider many of the items included in ComEd’s proposed revenue
5 requirement, and the Commission expects that the audit will provide additional
6 evidence on these subjects.” (Interim Order, Page 84) Thus, the normality of
7 distribution O&M in 2000 is clearly within the scope of the audit. If Liberty had
8 limited the audit to the prudence of expenses incurred in 2000, without also
9 considering the normality of such expenses, Liberty would have failed to meet the
10 Commission’s expectations for the investigation with regard to distribution O&M, as
11 those expectations were expressed in the Interim Order.

12
13 Q. Mr. Williams goes on to criticize Liberty’s use of a trend line analysis to determine a
14 reasonable level of expense for 2000. Do you have a response?

15 A. Yes. If ComEd had maintained records that allowed identification of abnormal, non-
16 recurring expenses associated with the recovery program and response activities, it
17 would not have been necessary for Liberty to rely on alternative methods to
18 determine a normal level of distribution O&M expense. In the absence of specific
19 data on incremental recovery program and response expenses, it is perfectly
20 reasonable to examine the level of expenses incurred in other recent years to
21 determine a normal level of distribution O&M for the purpose of establishing the
22 delivery services revenue requirement. In this regard, Liberty was really quite

1 conservative in taking 1991 as its base year and escalating the distribution O&M in
2 that year by 3.05% per year to calculate the normalized test year level of expense.

3
4 Q. Why do you say that Liberty was conservative in its method of calculating the
5 normalized level of distribution O&M expense?

6 A. As I explained in my direct testimony in this phase of the case, if Liberty had used a
7 three-year average of the years 1991-1993 as the base for calculating the normal level
8 of expense, the calculated level of normal distribution O&M would have been less by
9 \$6.4 million. In fact, if Liberty had used any year or combination of years in the
10 fifteen years prior to 1998 as the base and escalated that base by 3.05% per year to
11 calculate the normal expense level, the result would have been a lower level of
12 expense than the \$287.1 million that Liberty actually calculated. By choosing 1991
13 as the base year in its normalization method, Liberty made as conservative a choice as
14 it reasonably could have made, given the necessity of relying on an analysis of
15 historical expenses to determine the normal level of distribution O&M.

16
17 Q. Why do you believe it was necessary in these circumstances to rely on an analysis of
18 historical expense levels to determine the normal amount of distribution O&M?

19 A. In considering the normality of test year expenses to be used for ratemaking purposes,
20 the first question is whether the level of expenses actually incurred in the test year
21 was normal. If the answer to this question is yes, then no normalization adjustment is
22 necessary. If the answer is no, then the second question is how best to adjust the
23 actual expense level to reflect normal conditions. If available data allow specific

1 identification of abnormal or non-recurring expenses, then the actual test year
2 expenses can be adjusted to remove such abnormal expenses. In fact, this is what
3 ComEd itself did with regard to certain distribution O&M relating to activities such
4 as the merger, discontinued programs, and storm restoration. However, the Company
5 made no adjustment to remove any non-recurring expenses associated with recovery
6 program and response activities in 2000.

7 Even after the adjustments proposed by ComEd, the distribution O&M
8 expenses incurred in 2000 were still abnormally high. As ComEd did not have the
9 accounting records to identify expenses incurred as a result of the recovery program,
10 Liberty could not adjust the actual expenses by removing those non-recurring costs.
11 In the absence of such data, Liberty had to rely on an alternative method to normalize
12 expenses incurred in 2000. In these circumstances, reliance on historical data is
13 reasonable, and as far as I can determine, ComEd has not presented a better way of
14 normalizing the distribution O&M expenses incurred in 2000. Failure to normalize
15 the distribution O&M incurred in 2000 would be an implicit acceptance that there
16 were no abnormal expenses incurred in 2000 associated with the recovery program, a
17 position that I do not believe is plausible.

18
19 Q. On Pages 7-8 of his testimony, Mr. Williams presents his own trend analysis that
20 purports to show that “spending” by ComEd in 2000, when the Company as a whole
21 is considered, was actually below the trend line from 1991. Is the trend line analysis
22 presented by Mr. Williams valid for the purpose of determining the normality of
23 delivery services spending incurred by ComEd in 2000?

1 A. No. First, Mr. Williams includes expenses related to production and transmission in
2 his analysis. As these functions are outside the scope of the delivery services revenue
3 requirement, inclusion of production and transmission expenses in his analysis
4 renders it worthless for the purpose of analyzing the normality of distribution O&M
5 incurred in 2000. Second, although Mr. Williams characterizes his analysis as
6 addressing “spending” by ComEd, he includes depreciation expense in his analysis. I
7 am not aware of any definition of spending that would include depreciation expense,
8 as depreciation represents amortization of previous capital expenditures over their
9 useful lives, not current cash disbursements for expenses. Therefore, the comparisons
10 presented by Mr. Williams are of no value in examining the normality of distribution
11 O&M expense incurred by ComEd in 2000.

12

13 Q. Mr. Williams also criticizes Liberty for concentrating its analysis on distribution
14 O&M. Do you agree that the focus of Liberty’s analysis is too narrow?

15 A. No. Mr. Williams states that Liberty’s examination would be “more prudent” if it
16 were expanded it to include all accounts for Electric Service Expenses, or an analysis
17 of Transmission and Delivery Services, or an analysis of all Delivery Services
18 expenses, not just distribution O&M (Williams at 15-16). In my opinion expanding
19 the examination to include all Electric Services Expenses, such as production O&M,
20 would not be an improvement, as this would bring in costs that have nothing to do
21 with delivery services. I find the suggestion by Mr. Williams that the inclusion of
22 transmission costs would improve the analysis to be particularly questionable,
23 because other ComEd witnesses have testified that transmission costs should not be

1 considered in an analysis of delivery services revenue requirements, as transmission
2 costs are outside the jurisdiction of the Illinois Commerce Commission. With regard
3 to an analysis of all Delivery Services expenses, expanding the review to include
4 customer related expenses, the other major component of operation and maintenance
5 costs directly associated with the provision of delivery services, would not materially
6 alter the results of the Liberty study, as shown in my Schedule DJE-B-1
7 accompanying this rebuttal testimony. As can be seen on this schedule, applying the
8 3.05% escalation factor to the actual customer related expenses incurred in 1991
9 actually results in a slightly lower level of normalized customer related O&M
10 expense than the level of expense determined by Liberty.

11
12 Q. On Page 17 of his testimony, Mr. Williams criticizes Liberty for relying on 2004
13 forecasted expenses to develop a trend line to escalate the actual 1991 distribution
14 O&M. Is this criticism valid?

15 A. No. The criticisms by Mr. Williams on Page 17 and the alternatives suggested on
16 Page 18 are directed at the method used by Liberty, not whether the 3.05% escalation
17 calculated by Liberty is itself realistic. As I explained in my direct testimony of this
18 phase, the 3.05% escalation factor developed by Liberty is a reasonable escalation
19 factor to recognize the effect of inflation and system growth on distribution O&M
20 over time, regardless of how that escalation factor is developed. If anything, that
21 escalation factor is probably on the high side, as it gives no recognition to the effect
22 of improvements in productivity that could reasonably be expected to take place over
23 time.

1

2 Q. On Page 32 of his testimony, Mr. Williams claims that, “implementing Liberty’s
3 analysis would require, on average, that every category of Distribution O&M expense
4 be reduced by 23.9%.” Is this claim accurate?

5 A. No. This assertion betrays a misunderstanding of the basic purpose of an adjustment
6 to normalize operation and maintenance expense. Liberty is not asserting that
7 ComEd has to make some special effort to reduce the actual spending on distribution
8 O&M incurred in 2000 by 23.9%. Rather, it is Liberty’s finding that when abnormal
9 expenses that ComEd incurred in 2000 are eliminated, the normal, prospective level
10 of distribution O&M is significantly less than the level of distribution O&M incurred
11 in the 2000 test year. ComEd will not have to undertake any extraordinary measures
12 to achieve reductions in distribution O&M. Rather, as the non-recurring expenses
13 cease, the level of distribution O&M will return to a normal level. Mr. Williams has
14 presented nothing to refute this finding.

15

16 Q. On Page 61 of his direct testimony, Company Witness Dr. James Williams asserts
17 that “the difference between the 3% annual figure urged by ComEd, compared with
18 the 4% peer figure, supports the conclusion that Liberty’s selection of the 1991 and
19 2004 beginning and end points for its ‘straight line analysis’ results in the greatest
20 possible disallowance and smallest possible increase in O&M for ComEd.” Does the
21 method used by Liberty result in the greatest possible reduction to distribution O&M
22 for ComEd?

1 A. No. Liberty could have achieved a significantly larger reduction to distribution O&M
2 by selecting a year other than 1991 as the base year in its analysis and also using an
3 escalation rate less than 3.05% by offsetting the effect of escalation from inflation and
4 system growth with a productivity factor. Based on the actual level of distribution
5 O&M expense incurred by ComEd historically, Liberty's proposed normalization
6 adjustment is quite conservative.

7

8 Q. On Pages 6-7 of his Phase II direct testimony, Company Witness Hill states that in
9 quantifying its incremental adjustment to distribution O&M in the Interim Order,
10 Liberty failed to reflect the fact that ComEd had removed \$15.196 million of year
11 2000 Distribution O&M costs in its initial filing and that the \$15.196 million of
12 expense reductions are, in effect, double counted in Liberty's proposed adjustment to
13 normalize distribution O&M. Do you agree that Liberty has double counted the
14 \$15.196 million of expense reductions?

15 A. No. Liberty calculated normalized test year distribution O&M of \$287,056,000,
16 excluding incentive compensation (Audit Report, Page II-53). The Interim Order,
17 which includes ComEd's adjustments to distribution O&M, reflects distribution
18 O&M \$357,206,000 excluding incentive compensation (Schedule DJE-B-2). The
19 difference is \$70,150,000, the incremental adjustment to the distribution O&M in the
20 Interim Order proposed by Liberty (Audit Report, Page II-1). In other words,
21 \$70,150,000 is the incremental adjustment necessary to bring the distribution O&M
22 (excluding incentive compensation) in the Interim Order, which is net of the \$15.196

1 million referred to by Mr. Hill, down to the normalized expense level proposed by
2 Liberty. Contrary to Mr. Hill's assertion, there is no double counting.

3
4 Q. On Page 29, of his testimony, Mr. Hill states that he does not oppose Liberty's
5 adjustment to reflect capitalization of a portion of incentive compensation charged to
6 distribution O&M, as long as there is an adjustment to rate base to recognize the
7 capitalized amounts. Does this change your position on the capitalization of a portion
8 of the test year incentive compensation charged to distribution O&M?

9 A. No. I continue to believe that it would be inappropriate to incorporate a pro forma
10 adjustment to test year expenses to recognize capitalization of a portion of incentive
11 compensation charged to distribution O&M, for the reasons explained in my direct
12 testimony in this phase of the case.

13
14 Q. What is your understanding of the testimony of Company Witnesses Houtsma and
15 Frangipane on accounting for the recovery program and response expenses as
16 extraordinary items?

17 A. I understand the position of both Witnesses Houtsma and Frangipane to be that
18 ComEd was not required under either generally accepted accounting principles or the
19 FERC uniform system of accounts to account for the recovery program and response
20 costs as extraordinary items. Fair enough. However, this is not the same thing as
21 saying that ComEd was prohibited from establishing accounting procedures that
22 would have allowed identification of such expenditures. Having elected not to do so,
23 ComEd should not be heard to complain about Liberty's reliance on alternative

1 methods to determine the normalized level of test year expenses. Just because
2 ComEd was not required to account for the recovery program and response costs as
3 extraordinary items does not mean that those costs should be treated as normal,
4 recurring expenses for the purpose of establishing the delivery services revenue
5 requirement. Doing so would allow the Company to continue to recover those
6 abnormal expenses year after year through the delivery services revenue requirement,
7 for as long as the rates established in this case are in effect.

8

9 **B. Customer Related Expenses**

10 Q. Have you reviewed Mr. Hill's testimony on customer related expenses?

11 A. Yes. Mr. Hill accepts most of Liberty's proposed adjustments to customer related
12 expenses, but opposes certain of the adjustments proposed by Liberty. I would
13 simply note again that comparing the total level of customer related expenses incurred
14 in 2000 to the level of customer related expenses incurred in other recent years, the
15 effect of the normalization adjustments proposed by Liberty appears to be quite
16 conservative. I believe that the Commission should take this into account, to the
17 extent that any of Liberty's proposed adjustments to customer related expenses
18 remain in dispute.

19

20 **C. Administrative and General Expense**

21 Q. On Page 20 of her testimony, Ms. Houtsma implies that Liberty's adjustments to
22 administrative and general expense are inconsistent with the Commission's use of a

1 labor allocator to assign administrative and general expense to delivery services. Do
2 you agree?

3 A. No. The Commission's use of a labor allocator assigns a portion of all administrative
4 and general expenses to delivery services. If administrative and general expenses
5 include a cost that should not be recoverable through the delivery services revenue
6 requirement, then absent a specific adjustment to remove that cost, a portion of the
7 cost equal to the labor allocator times that total cost will be included in the delivery
8 services revenue requirement. Liberty has identified certain administrative and
9 general expenses that should be eliminated from the cost of service. To determine the
10 effect on the delivery services revenue requirement, Liberty then applied the labor
11 allocator to the expenses being eliminated. This is perfectly consistent with the
12 Commission's use of a labor allocator to assign administrative and general expenses
13 to delivery services.

14

15 Q. On Page 58 of his testimony, Mr. Hill states that he does not oppose Liberty's
16 adjustment to reflect capitalization of a portion of incentive compensation charged to
17 administrative and general expense, as long as there is an adjustment to rate base
18 recognizing the capitalized amounts. Does this change your position on this issue?

19 A. No. Again, I continue to believe that it would be inappropriate to incorporate a pro
20 forma adjustment to test year expenses to recognize capitalization of a portion of
21 incentive compensation charged to administrative and general expense, for the
22 reasons explained in my direct testimony in this phase of the case.

23

1 **D. Plant in Service**

2 Q. On Pages 15-16 of his testimony, Mr. Hill states his opposition to Liberty's proposal
3 to reduce plant in service included in rate base by \$9.1 million based on the fact that
4 the Company had not actually expended these funds as of June 30, 2001. He
5 characterizes this adjustment as "incorrect, inappropriate, and unfair." Do you agree
6 with this characterization?

7 A. No. As the Company is not projecting the accumulated reserve for depreciation or
8 accumulated deferred taxes beyond the end of the 2000 test year, I think a cutoff date
9 of June 30, 2001 for plant expenditures is perfectly reasonable. Without such a cutoff
10 point the relationship between plant in service and the other elements of rate base
11 becomes more distorted than it already is from recognizing additions to plant beyond
12 the end of the test year without also recognizing concomitant growth in accumulated
13 reserve for depreciation or accumulated deferred taxes.

14 What I find most puzzling about Mr. Hill's opposition, however, is that
15 Liberty's proposed reduction to plant in service based on actual expenditures as of
16 June 30, 2001 is less than the analogous adjustment adopted by the Commission in its
17 Interim Order. That is, Liberty is proposing a downward adjustment of \$9,148,000.
18 In the Interim Order, the Commission adopted a downward adjustment to ComEd's
19 proposed pro forma plant in service of \$11,038,000 based on actual substantiated
20 spending on certain plant projects as of June 30, 2001, as presented by Staff. Thus, if
21 Mr. Hill were to prevail on this matter, and the Commission were to reject Liberty's
22 findings in the Audit Report, it would then go back to the adjustment in the Interim
23 Order and reduce the pro forma plant in service by \$11,038,000 rather than the

1 \$9,148,000 in the Audit Report. That is, it would do so unless Mr. Hill is just using
2 this response to the Audit Report to get the Commission to change something that it
3 has already decided, rather than responding to the Audit Report, which is something
4 that I am sure he would not do.

5

6 **E. Depreciation Expense**

7 Q. On Page 30 of his testimony, Company Witness Hill states that he does not oppose
8 Liberty's proposed adjustment to reflect reduced depreciation accrual rates as long as
9 there is a coordinated pro forma adjustment to rate base to recognize the effect of
10 lower depreciation accrual rates on the accumulated reserve for depreciation as of the
11 end of the test year. Does this change your position on whether the Commission
12 should adopt Liberty's proposal to reflect lower depreciation rates?

13 A. No. I continue to believe that the Commission should not adopt any changes to the
14 Company's proposed depreciation accrual rates at this time, for the reasons stated in
15 my direct testimony in this phase.

16

17 Q. Does this conclude your rebuttal testimony?

18 A. Yes.

19